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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

New Soviet - Yugoslav Cooperation: Buildup for Tito's Visit

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1972

INTELLIGENCE MEMORANDUM

NEW SOVIET-YUGOSLAV COOPERATION: BUILDUP FOR TITO'S VISIT

Introduction

1. Tito's visit to Moscow comes at a time when Soviet-Yugoslav relations are friendlier than at any time since 1968. Following Brezhnev's visit to Belgrade last September – a month before Tito came to Washington – economic activity has been intense. This memorandum examines the resurgence of Soviet-Yugoslav economic relations and evaluates its potential impact on the short-term – and longer term – prospects for the Yugoslav economy.

Summary

2. An upsurge in Soviet-Yugoslav trade and major Soviet credit offers to Belgrade have created a highly favorable atmosphere for Tito's visit to Moscow beginning 5 June. Under recent agreements, the trade promises to be more useful to both sides than in the past, and is thus less likely to be greatly disturbed by inevitable shifts in the political climate.

3. Belgrade's eagerness for trade with the USSR revived in 1970 when balance-of-payments deficits with the West began to get out of hand. Yugoslav-Soviet trade, after a ragged growth since 1965, shot up during 1970-71 by 46%. This expansion, and also increased trade with other countries of the Council for Mutual Economic Assistance (CEMA), only began to have an impact on the balance of payments with the West late in 1971.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

4. The second stage in the improvement of economic relations was a round of Soviet offers of assistance following the visit of Party Chief Brezhnev to Belgrade in September 1971. In rapid succession, the USSR came up with a $130 million Soviet credit for construction of an alumina plant in Bosnia-Hercegovina; a $100 million barter arrangement between the Tol'yatti automobile plant and Yugoslavia's Fiat affiliate in Serbia; promises of additional credits of $500 million to $800 million for exploiting mineral and power resources in Yugoslavia's less developed republics; and a supplementary protocol adding $540 million to planned trade in 1971-75, including more Soviet deliveries of fuels and cotton.

5. These deals are good business for both sides. They give the USSR an outlet for machinery, much of which was previously resisted by the Yugoslavs; help to fill gaps in Yugoslavia's raw materials supplies; and lend support to Belgrade's efforts to spur growth in the less developed southern regions. The trade expansion also is in line with Moscow's goal of gaining a foothold in the weaker republics in preparation for dealing with and influencing post-Tito Yugoslavia. On the other hand, Belgrade is by no means increasing its economic dependence on the USSR to the danger point -- the Soviet share of trade probably will not increase much beyond its present 11%. In fact, the expansion is likely to give only short-term relief to the balance of payments; Yugoslav enterprises still have a huge appetite for Western goods.

6. In the longer run, the Soviet deals may aggravate Yugoslavia's already difficult task of compromising northern and southern regional objectives. To the south, trade with the USSR and the rest of CEMA, together with development credits, dangles the prospect of growing fast enough to catch up with the north. Southern interests thus may become even stronger advocates of rapid industrialization and trade with CEMA in opposition to northern efforts to make the economy more competitive and more oriented toward trade with the West.

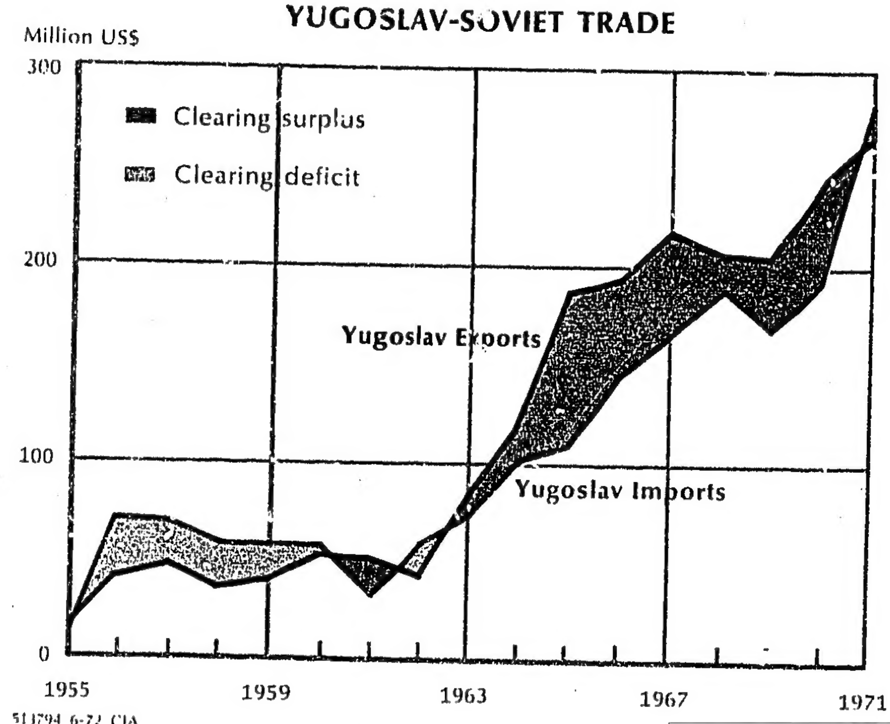
Discussion

Upsurge in Trade

7. The revival of Yugoslav-Soviet economic relations began in mid-1970. The disastrous trade results in the first half of 1970 – when Yugoslavia incurred a hard currency trade deficit of $675 million – provided the impetus. A decision was made to redirect trade toward the USSR and other CEMA countries, and to draw down the surplus on clearing account that Yugoslavia had been accumulating with these countries since 1965.

During 1971, imports from the USSR increased by 46% while exports to the USSR rose by 11%. As a result, Yugoslavia ran a deficit in trade with the USSR for the first time since 1962 (see the chart).

YUGOSLAV-SOVIET TRADE



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8. In September 1971, Brezhnev visited Belgrade, setting off an extraordinary flurry of Yugoslav-Soviet economic negotiations, not seen since the resumption of trade in the mid-1950s. In rapid order, Tarosov, Soviet Minister of the Automotive Industry; Baybakov, Deputy Chairman of the Council of Ministers and Chairman of the State Planning Committee; and Grechko, Minister of Defense, visited Yugoslavia. In contrast to the past, negotiations were conducted in a businesslike and cordial manner. There were few of the political conflicts that had delayed agreement on past protocols.

9. The first plum that the USSR offered following Brezhnev's visit was a $130 million credit for construction of an alumina plant at Zvornik in Bosnia-Hercegovina. The deal was announced in November 1971 and finally approved in January 1972. Earlier, in the fall of 1971, negotiations

with Kaiser Aluminum on the construction of a large combine near Mostar in Bosnia-Hercegovina had fallen through. The Zvornik plant, with an alumina capacity of 600,000 metric tons, reportedly will be Europe's largest. Repayment will be made by shipping to the USSR all alumina produced at the plant, plus 500,000 tons of bauxite, for a period of ten years. Interest is pegged at a relatively low 4.5%. Moreover, the USSR reportedly has agreed to purchase 80% of the alumina at "world prices"; only 20% of the output will be allocated for repayment of the credit.

10. In December 1971, during Baybakov's trade visit, a supplementary protocol was signed which adds $540 million to planned trade during 1971-75. A turnover of $3.6 billion now is scheduled, nearly double actual deliveries in 1966-70. Furthermore, this new protocol comes on the heels of the expanded trade of 1971 – the first time in many years that the Yugoslav-Soviet trade plan was fulfilled.

11. In February 1972, yet another deal was concluded. This one, a $100 million barter arrangement involving Yugoslavia's Fiat affiliate Zastava, was originally discussed last September during Tarasov's visit. Zastava will export automobile parts such as lights, batteries, cables, ignitions, and steering wheels for use at the Soviet Tol'yatti automobile plant. In return, the USSR will ship the Yugoslavs about 5,000 Zhiguli cars, industrial equipment, and unspecified commodities. Zastava already has been supplying spare parts to Tol'yatti for the past few years, and the new contract substantially increases the firm's dependence on the USSR.

12. The most recent economic negotiations – in Moscow in early April – gave rise to a protocol calling for Soviet credits of $500 million to $800 million for development of mineral and power resources in Yugoslavia's less developed regions and for a larger exchange of raw materials. The agreement goes a long way toward meeting earlier Yugoslav demands for increased Soviet deliveries of coke, crude oil, natural gas, and raw cotton. Details are to be worked out following Tito's visit. The protocol also envisions, for the first time, Yugoslav participation in construction projects in the Soviet Union. Pilot projects will include building two 2,500-bed hotel complexes – a field in which the Yugoslavs have considerable international experience – and construction of a furniture factory and two leather-processing factories. Moreover, the USSR has agreed to renegotiate outstanding contracts on ships ordered from Yugoslav firms. Previously the USSR had refused to consider the demands of Yugoslav shipbuilders for new contracts to protect them against rising costs.

13. Trade with the other CEMA countries is also looking up. But although this trade is larger than that with the USSR, its expansion will not provide anything like the same level of investment credits or a

comparable inflow of industrial raw materials. Total trade with Eastern Europe rose in 1970-71 by more than one-fourth, from just under $700 million to nearly $900 million, and it is slated to rise by over 50% in 1971-75. In 1971 the East Germans extended a $66 million credit to the Boris Kidric Aluminum Combine for building a new alumina and electrolysis plant at Sibenik in Croatia. East Germany also is participating in the construction of a $23 million zinc smelter in Slovenia and is a partner in one of Yugoslavia's first joint investment deals – the Celje Zinc Plant, also in Slovenia. In May 1972, Hungary reportedly agreed to provide $45 million in equipment and a $5 million credit for construction of an alumina plant in Obrovac, near the Adriatic. This deal is a significant addition to the 1971-75 trade protocol.(1)

14. In addition, the Yugoslavs plan an increase in industry-to-industry cooperation with East European countries, especially Czechoslovakia. Two large ventures were concluded with the Strojsmalt firm of Czechoslovakia in December 1971. The deals, each for a five-year period, are worth a total of $70 million in commodities exchanged and involve two of Yugoslavia's largest electrical firms, Electronic Industry and Rade Koncar. In another large cooperative effort, automobile parts are being exchanged between the Crvena Zastava enterprise and the Polmot automobile firm of Poland. To a lesser degree, some Hungarian firms also are engaged in supplying parts to Zastava. To facilitate these ventures and otherwise to expand trade, joint banks have been set up between Yugoslavia and all CEMA countries except East Germany and the USSR.

The Stormy Past

15. The renaissance in Yugoslav-Soviet economic relations stands in sharp contrast to the slowdown in trade since the spurt in 1963-65. However, Yugoslavia's relations with the USSR and the other countries of CEMA have blown hot and cold before. Trade with CEMA countries was severed in 1949, after Yugoslavia was ousted from the Cominform, and was resumed only in the mid-1950s. The Khrushchev visit of 1955 sparked greater economic exchanges and led to the extension of some $464 million in credits, but only $109 million had been drawn when differences over the Hungarian uprising again chilled relations.

16. A second Khrushchev visit to Belgrade, this time in 1962, ushered in a new era of economic and political rapprochement. Even though the growth of trade with the USSR began to level off after the economic reform of 1965, political relations continued to thaw; so much so that by the

1. Other East European credits, granted in the early 1960s, were $110 million from Czechoslovakia and $30 million apiece from Romania and Poland.

fall of 1967 Soviet-Yugoslav relations were the best they had been since the 1948 break. The invasion of Czechoslovakia in 1968 shattered the serenity again and adversely affected trade – in 1969 Yugoslav exports declined slightly, while Soviet exports to Yugoslavia registered a drop of 10%.

Roots of Revival

17. The renewed interest of Yugoslavia in Soviet trade and aid reflects the two overriding problems in the Yugoslav economy: periodic crises in the balance of payments and financing the development of backward regions. Although massive Western assistance temporarily bailed Yugoslavia out of its most recent balance-of-payments crises,(2) the economy will be severely strained to meet heavy debt repayments in the mid-1970s. Moreover, the regime's preoccupation with raising per capita income in the less developed regions (Kosovo, Montenegro, Macedonia, and Bosnia-Hercegovina) has compounded balance-of-payments difficulties. Not only has the income gap between the more and less developed regions widened,(3) but the federal government's policy also has encouraged the poorer areas to import Western machinery and equipment to support industries that depend on CEMA countries for export markets.

18. The most recent bout in Yugoslavia's perennial battle with the balance of payments began to materialize in 1969. Import controls had been liberalized in 1967 and credit controls were relaxed in 1968 to help speed the economy's recovery from the 1967 recession. After a slow start, industrial production rose strongly during 1969-71 – and so did prices and imports (see Table 1). The cost of living went up by nearly 40% during 1969-71, while imports soared upward by more than 80%. Exports, which had stagnated in 1968, grew by 44% during 1969-71 – ordinarily a good gain but no match for the leap in imports in this period.

19. Domestic inflation left its mark on the balance of payments, increasing the cost of export goods and leading to a slowdown in sales abroad. The physical volume of exports grew by only 19% during 1969-71, while export prices also increased 19% during the same period. Moreover, the buoyant Yugoslav market, as well as driving up imports, provided easy sales for domestic products, leaving little inducement for many producers to scramble for foreign markets, particularly in the West. Thus the trade imbalance – virtually all of it in hard currency – climbed to a record $1.2 billion in 1970 and continued to widen, reaching $1.4 billion in 1971. Even with impressive gains in earnings from tourism and workers' remittances,

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Table 1

Yugoslavia: Economic Indicators

	1968	1969	1970	1971
	Annual Percentage Increase			
Cost of living	5	8	11	16
Industrial production	6	12	8	11
Imports	5	19	35	13
Exports	1	17	14	8
	Million US $			
Trade balance	-533	-659	-1,195	-1,437

the deficit on current account hit record levels in both years. These deficits, coupled with increasing resistance of the Common Market toward Yugoslav exports, especially agricultural products, forced the Yugoslavs to seek an increased volume of trade with their CEMA partners, particularly the USSR.

20. Another compelling reason for the Yugoslav interest in Soviet assistance was the lagging development of the south. From the beginning, Tito's postwar government gave top priority to narrowing the income gap between the poorer regions and the more industrialized north – Slovenia, Croatia, and Vojvodina. Actively pursuing a policy of forced growth during the 1950s, the regime pushed heavy capital investment in the backward areas. Not only did forced growth fail to lessen the income disparity, but also the investments undertaken bred inefficient enterprises and contributed to balance-of-payments difficulties.

21. In the mid-1960s the government tried to abandon the forced growth policy, instituting a series of reforms designed to promote economic efficiency. By stressing monetary restraint, better allocation of investment funds and foreign exchange, and more decentralization of decisionmaking, the reforms favored the more developed regions and led to a further widening of income levels. Moreover, as the movement toward efficiency gained momentum, the northern regions became increasingly reluctant to divert their resources to support what they saw as wasteful investments in the south. In particular, the trade-minded Croats became highly touchy about the National Bank's practice of reallocating hard currency to the poorer regions to feed their import requirements. Bickering over the

financial role of the north in the south's development contributed to the wholesale expulsions of Croat political leaders in 1971.

22. To the beleaguered federal government, Soviet aid – in the form of credits and purchasing deals – was welcome. On the one hand, Soviet development credits were in line with the demands of the underdeveloped regions for construction of factories and mining facilities. On the other hand, the Soviet credits might make it unnecessary in the next five or ten years to increase the burden on the Croats and Slovenes to finance southern development. Furthermore, increasing the south's intake of CEMA exports would help to balance regional trade flows as well as to reduce balance-of-payments pressures.

Costs and Benefits

23. In deciding to push for increased trade with the USSR, the Yugoslavs have had to weigh the obvious economic benefits of the clearing trade against substantial political risks. On the plus side, the USSR has provided crude oil, coking coal, and other key raw materials which otherwise would have to be purchased for hard currency. To pay for these, Yugoslavia has been able to ship machinery and manufactures for which there is little demand on Western markets. On the debit side, becoming more dependent on the USSR for strategic imports could complicate Yugoslavia's position as a maverick political state that prides itself on nonalignment.

24. Moreover, for several years the Yugoslavs have attempted unsuccessfully to move away from the rigid barter trade that has forced them to accept some unwanted goods and has conflicted with their decentralized economic system. The Zvornik deal provides a classic example of the disadvantages of barter trade. Since all alumina from the project will be exported to the USSR for ten years, Yugoslavia will have less chance and incentive to develop an aluminum industry that is competitive in Western markets. The irony of the situation is that nonferrous metals, and especially aluminum, are sectors in which Yugoslavia's medium-term development and hard currency export prospects are brightest. To the Yugoslavs, however, this is no longer a painful price to pay to obtain at a fairly low cost a factory in a priority industry and in a backward region.

25. In spite of the drawbacks, the Soviet Union has long been one of Yugoslavia's key trading partners – 1971 trade turnover with the USSR ran almost $550 million, 11% of total trade. This was 80% above US-Yugoslav trade, and was exceeded only by West Germany and Italy. The USSR is Yugoslavia's best single market for manufactures, especially those produced by its less efficient industries. As Table 2 indicates, the Soviet Union concentrates its imports of Yugoslav manufactures in three

Table 2

Yugoslav Exports to the USSR
1970

	Exports to the USSR	Total Exports	Exports to the USSR as a Percent of Total Exports
	Million US $		
Total	**242**	**1,679**	**14**
Of which:			
Food, beverages, and tobacco	26	314	8
Raw materials	9	158	6
Of which:			
Nonferrous ores	6	30	20
Fuels and power	Negl.	20	Negl.
Chemicals	30	97	31
Semimanufactures	32	492	7
Of which:			
Ferrous metals	8	73	11
Nonferrous metals	16	182	9
Machinery and transport equipment	94	381	25
Of which:			
Electrical machinery and appliances	32	119	27
Transport equipment	54	189	29
Consumer goods and light manufactures	51	214	24
Of which:			
Clothing	24	85	22
Footwear	24	55	44

main categories: chemicals, machinery and transport equipment, and consumer goods. Many of these products are not competitive on Western markets. In 1970, the most recent year for which data are available, the USSR accounted for almost one-third of Yugoslav chemical exports and one-fourth of both machinery and transport equipment and consumer exports.

26. Imports from the Soviet Union fill important gaps in Yugoslav supplies of raw materials (see Table 3). Raw materials and fuels accounted for 45% of Yugoslavia's total imports from the USSR. The USSR provides over two-fifths of Yugoslavia's coking coal imports, nearly one-fourth of imported crude petroleum, and smaller percentages, but important quantities, of ferrous and nonferrous metals.

27. The strategy of increasing imports from and exports to the USSR and other CEMA countries appears to be paying off. In the first half of 1971, Yugoslavia incurred a horrendous deficit of $854 million in total commodity trade. However, in the second half of the year, when trade with CEMA really started rolling, the semiannual deficit was trimmed to $583 million. Exports to CEMA countries in the second half of 1971 were 39% of total exports, compared with 34% in the first half; imports rose from 21% to 23% of total imports in the respective periods. Meanwhile, the hard currency deficit declined from $694 million in the first half of 1971 to $536 million in the second half. The favorable trends were continuing in the first quarter of 1972 – total exports were up 23%, imports down 11%, compared with the same period last year. Exports, which had covered only 50% of imports in the first quarter of 1971 were now offsetting 70% of the import bill.

Prospects

28. Yugoslav-Soviet trade should develop in the 1970s on a more stable basis than in the past, quite apart from ups and downs in political relations. By agreeing to finance big new projects needed by Yugoslavia, the USSR has guaranteed itself a large secure market for plant and equipment. Thus the USSR has become less reluctant to absorb increased sales from firms in Yugoslavia's less developed republics. At the same time, the large deliveries of Yugoslav alumina and bauxite agreed upon have opened up the possibility of Soviet shipments of additional fuels and metals to Yugoslavia. In short, an expansion of the trade is in the economic interest of both parties, and that is likely to stabilize trade even in times of renewed political tension.

29. The revival in Yugoslav-Soviet trade will not basically alter the structure of Yugoslav trade, nor will it necessarily help to ease future

Table 3

Yugoslav Imports from the USSR
1970

	Imports from the USSR	Total Imports	Imports from the USSR as a Percent of Total Imports
	Million US $		
Total	**193**	**2,874**	**7**
Of which:			
Food, beverages, and tobacco	3	207	1
Raw materials	36	314	11
Of which:			
Raw cotton	14	110	13
Fuels and power	47	138	34
Of which:			
Hard and coking coal	15	36	42
Crude petroleum	23	99	23
Chemicals	14	267	5
Semimanufactures	53	827	6
Of which:			
Ferrous metals	21	237	9
Nonferrous metals	23	190	12
Machinery and transport equipment	33	955	3
Consumer goods and light manufactures	7	146	5

balance-of-payments pressures. The preponderance of Yugoslav trade -- and foreign debts -- still will be with the West, and rigid controls on imports may be needed to avoid another crisis by the mid-1970s, when debt payments to the West will be extremely large. But expanded trade -- plus Soviet credits -- could lighten the impact of investment and import controls, especially on the less developed republics.

30. To the extent that the trade of backward republics becomes even more entangled with the Soviet and CEMA markets, it may become increasingly difficult to carry out policies designed to increase industrial efficiency and competitiveness in these regions. The CEMA trade offers an easier way out, one which promises a high rate of growth and significant progress in catching up with the northern level of development. At the same time, however, the gap between the northern and southern views on economic policy is likely to widen -- the south pushing harder for rapid growth and closer ties with CEMA, in conflict with northern demands for structural improvements in output, more efficient resource allocation, and more economic incentives to expand trade with the West. The Yugoslav balancing act between the desires and needs of north and south thus is likely to become even more precarious.

31. The Soviet economic offensive also has implications for Yugoslav foreign policy. The indulgent attitude of the USSR in recent negotiations may have been partly aimed at smoothing over Tito's reservations about his upcoming trip to Moscow. Tito has much to be pleased about -- the Yugoslavs will be getting some needed assistance from the USSR at a time when Yugoslavia's ties with the West remain strong. And the USSR too should be pleased -- over the longer run its assistance could give it some of the increased political leverage in the south that it has long been seeking and a larger potential stake in the politics of a post-Tito Yugoslavia. Although Moscow certainly will portray Tito's visit as a movement toward greater unity in Eastern Europe -- symbolized by the Order of Lenin recently awarded Tito -- the USSR is likely to take a soft political line with him, not pressing for any of the political concessions that would in fact narrow policy differences.